



THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

May 28, 2002

The Honorable Edward J. Markey
U.S. House of Representatives
2108 Rayburn Building
Washington, DC 20515-2107

Dear Congressman Markey:

Thank you for your May 7th letter offering comments on the rules proposed by the New York Stock Exchange and the National Association of Securities Dealers relating to research analyst conflicts of interest and inquiring about the status of any enforcement activities by the Commission relating to research analyst conflicts of interest. As you requested, your letter was added to the public comment file on the NYSE and NASD proposed rules.

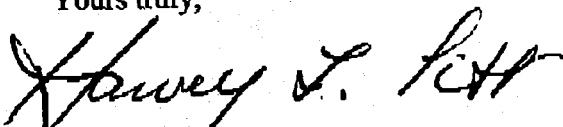
At an open meeting on May 8th the Commission approved the NASD and NYSE rules proposals, as amended, because we found that the rules were consistent with the Securities Exchange Act of 1934. But as we noted during that meeting, we view these new rules as only the first step, although a major one, in addressing conflicts that face analysts recommending stocks. In approving the rules, the Commission requested that the NASD and NYSE prepare a report on the operation and effectiveness of the new rules and submit it, together with any recommendations for changes or additions to the rules, within a year of their implementation. In addition, on April 24th the Commission announced that it has commenced a formal inquiry into market practices concerning the conflicts that can arise from the relationship between research analysts and investment banking. We are conducting the inquiry jointly with the NYSE, the NASD, New York Attorney General Eliot Spitzer, the North American Securities Administrators Association, and the states. The report from the NYSE and NASD, along with the findings from the joint inquiry, may indicate the need for further rulemaking or Commission action. Your comments will be very valuable as we continue to evaluate what further actions may be necessary for the protection of investors.

Your letter also seeks information about the Commission's enforcement activities relating to analyst conflicts of interest. At my request, our Division of Enforcement, with the assistance of other relevant Divisions and Offices, has prepared the enclosed memorandum responding to the questions you have posed.

The Honorable Edward J. Markey
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I hope you find the attached information useful and informative. If you have any questions, please call me at 942-0100.

Yours truly,


Harvey L. Pitt
Chairman

Enclosure

MEMORANDUM

May 28, 2002

TO: Harvey L. Pitt, Chairman
FROM: Division of Enforcement
RE: Correspondence from Edward J. Markey, Member of Congress

In correspondence addressed to you dated May 7, 2002, Congressman Edward J. Markey posed certain questions relating to the Commission's enforcement activities in the area of research analyst conflicts of interest. The following are responses our office has prepared in consultation with the Division of Market Regulation, the Office of the Executive Director, and the Office of Investor Education and Assistance.

1. **Over the past twelve months, how many enforcement inquiries has the Commission staff initiated in the area of research analyst conflicts-of-interest? When were these inquiries initiated? What are names of the firms and/or individuals involved in any of these actions, assuming that such information has been made public, either by the Commission or by the subject(s) of the investigation?**

Answer: During approximately the last twelve months, the Division of Enforcement has initiated 10 inquiries that have within their scope matters relating to possible conflicts of interest on the part of research analysts. In four of these matters, the potential conflict arises from personal trading by the analyst in the securities of companies covered by the analyst. In another matter, the potential conflict arises from receipt by the analyst of undisclosed compensation from an issuer. Some of the inquiries involve potential conflicts arising from firms' investment banking activities. Many of the inquiries are multi-faceted, and thus also include issues relating to other potential securities law violations. The Commission has not publicly identified the analysts or related firms that are the subjects of these inquiries.

2. **How many of these cases have moved into the formal investigation stage? What were the names of the firms and/or individuals in each such formal investigation, assuming that the existence of the investigation has been made public, either by the Commission or by the subject(s) of the investigation?**

Answer: The Commission has issued formal orders of investigation in connection with five of the 10 inquiries referred to above. At this time, Enforcement Division staff are pursuing the remaining five matters without formal orders. The Commission has not publicly identified the analysts or related firms that are the subjects of the formal investigations.

3. Overall, how many total formal investigations has the Commission initiated involving research analyst conflicts-of-interest?

Answer: During the last 15 years, the Commission has granted formal orders of investigation in connection with 21 investigations that raise issues of possible conflicts of interest by research analysts. The putative conflicts that are the subjects of these investigations arise in a variety of settings, including personal trading by analysts in the securities of companies that they cover, receipt of undisclosed compensation by analysts from companies they cover, insider trading or tipping by analysts, and conflicts arising from a firm's investment banking relationships.

4. How many times has either the Commission or the Chairman turned down a request from the SEC Enforcement Division staff to initiate an inquiry or formal investigation into allegations of securities analyst conflicts-of-interest?

Answer: We have not identified any instances in which the Commission or the Chairman rejected a request from the Enforcement Division staff to initiate a formal investigation into allegations of securities analyst conflicts of interest. The approval of the Commission or the Chairman is not required in order for the staff to initiate an inquiry.

5. How many of the SEC inquiries/investigations into securities analyst conflict-of-interest have resulted in civil lawsuits being brought by the Commission? How many have led to administrative proceedings? What are the names of the firms and/or individuals involved in each action?

Answer: Sixteen inquiries or investigations that raise issues of analyst conflicts of interest have resulted in the filing of enforcement actions in federal court, in an administrative context, or both. These matters arose in a variety of contexts, including receipt of undisclosed compensation by analysts from issuers, trading by analysts inconsistent with the analysts' own recommendations, preparation of false and misleading reports in exchange for compensation from issuers, and insider trading or tipping by analysts. A number of these actions also include allegations unrelated to analysts. One action does not make allegations concerning analysts, although analyst conduct was one of many aspects of the investigation.

In further response to this question, and in response to questions 6 and 7 below, please see the Litigation Releases and Administrative Proceedings attached as Exhibits A through P. These materials identify the parties involved in each action, the dates on which the actions were initiated, and their outcomes, where the matters have concluded.

6. When was each enforcement action initiated and when were final proceedings concluded (i.e., guilty verdict entered, settlement reached, case dismissed, etc.), if the matter has in fact been concluded as of May 1, 2002?

Answer: As explained above, please see the attached materials.

7. What were the results of each action?

Answer: As explained above, please see the attached materials.

8. How many enforcement actions in the area of research analyst conflicts-of-interest are currently pending?

Answer: There are two enforcement actions pending that relate to issues of possible conflicts of interest by research analysts. For further information on these actions, see the materials attached as Exhibits O and P.

9. In the Commission's view, is the SEC's portion of the proposed FY 2002 supplemental appropriation before Congress sufficient to enforce statutes and regulations relating to analyst conflict-of-interest, financial fraud and other provisions that protect investors from deceptive practices? If not, what level of funding would the Commission propose to accomplish these objectives?

Answer: The Administration's supplemental budget request includes \$20 million to augment the SEC's staffing levels in fiscal 2002 and 2003 by 100 positions. These positions are intended to enhance the Commission's accounting, oversight, disclosure, and enforcement programs. Forty-five of these positions are slated for the Division of Enforcement to help respond to the increasing number of investigations relating to financial fraud and reporting. The remainder will be deployed throughout the agency to enhance our Division of Corporation Finance, Office of Chief Accountant, and other offices in need of accountants and attorneys to deal with our immediate post-Enron needs.

In addition, in March, the Commission commenced a special study to examine our operations, resources, efficiency and productivity. The Commission commenced this study in part to implement a recommendation in a report earlier this year by the U.S. General Accounting Office that concluded that strategic planning could help the agency better identify and manage its resource needs.

10. During the same period (the last 12 months) how many investigations or inquiries into securities analyst conflicts-of-interest have been initiated by the self-regulatory organizations (SROs)? What has been the disposition of these cases?

Answer: The NASD has informed the staff of the Division of Market Regulation that during the last twelve months, it has announced three formal actions concerning research analyst conflicts of interest issues. Most recently, on May 7, 2002, the NASD issued a press release announcing that the firm of Hornblower & Weeks, Inc. was censured and fined \$100,000 and that its President was fined and suspended in connection with the firm's research report about

MyTurn.com. In addition to these formally announced actions, the NASD informed the staff that it has initiated 20 non-public investigations concerning research analyst conflicts of interest. During the last year, the NYSE reports that it has initiated 17 inquiries relating to conflicts of interest on the part of research analysts.

11. How many investor complaints has the SEC received, by phone call, mail, email, or through its web-page, regarding potential securities analyst conflicts-of-interest? What has been the disposition of these complaints?

Answer: Since public disclosure of the New York Attorney General's investigation of research analyst conflicts of interest, we have noted anecdotally an increase in investor complaints and other communications questioning the veracity and objectivity of analyst recommendations. However, the groups within the SEC that handle investor complaints and questions do not quantify investor contacts received on this subject.

Currently, the Enforcement Complaint Center receives an average of 500 to 700 complaints per day on a wide range of topics. This is approximately double the number of complaints we were receiving daily a year ago. This sharp increase began following disclosure of accounting irregularities at Enron Corp. and other public companies. According to the Enforcement Division's general procedures, when the Enforcement Complaint Center receives a complaint relating to a person or entity that is the subject of a pending inquiry or investigation, the complaint is immediately provided to the appropriate member of the Enforcement Division staff for review and follow-up as appropriate. Complaints containing new allegations of violations of the federal securities laws, including by research analysts, are analyzed by attorneys in the Office of Internet Enforcement to determine whether additional follow-up is warranted. Complaints concerning the brokerage industry that make only general allegations, express individual opinions, or comment on reports in the media are forwarded to the Commission's Office of Investor Education and Assistance for appropriate response.



United States
Securities and Exchange Commission

FAX TRANSMITTAL SHEET

PLEASE DELIVER THE FOLLOWING PAGES

TO: THE HONORABLE EDWARD J. MARKEY
ATN: MARK BAYER

FAX NUMBER: 226 - 7034

PHONE NUMBER: 225 - 2836

FROM: Matthew Shimkus, Senior Advisor
Office of Legislative Affairs

TOTAL NUMBER OF PAGES (Including cover sheet): 7

DATE: 5/28/02

TIME: 6:00pm

IF YOU DO NOT RECEIVE ALL PAGES, PLEASE CALL BACK AS
SOON AS POSSIBLE AT (202) 942-0010. Thank you.

REMARKS:

Mark -
Original (+ attachments)
will be delivered to your office
in the morning. Thanks -
Matt
942-0128